

# The State Bar of California

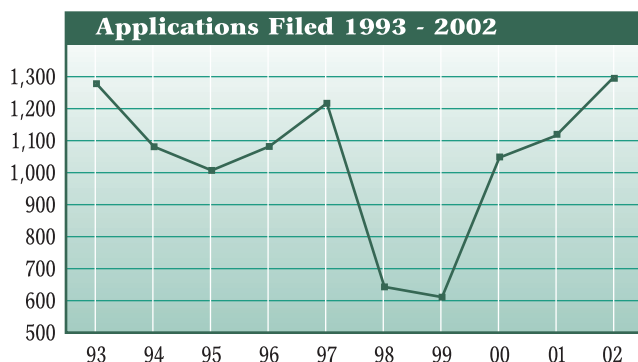
## Client Security Fund - 2002 Activities Report

### Public Protection

March 2002 marked the 30th anniversary of the Client Security Fund. Established in 1972, the Fund was created by Bar-sponsored legislation in recognition that disciplinary measures, as well as civil and criminal proceedings, were often insufficient remedies to alleviate pecuniary losses caused by a lawyer's dishonest conduct in the practice of law. Thus, the Client Security Fund is designed as a remedy for legal consumers, in addition to, but separate from discipline. While the discipline system protects the public by disciplining and removing errant lawyers from the practice of law, the fund protects the public by focusing on individual victims. Since its inception, the fund has reimbursed applicants approximately \$55 million. In 2002, the fund paid \$6,597,057 on 782 awards.

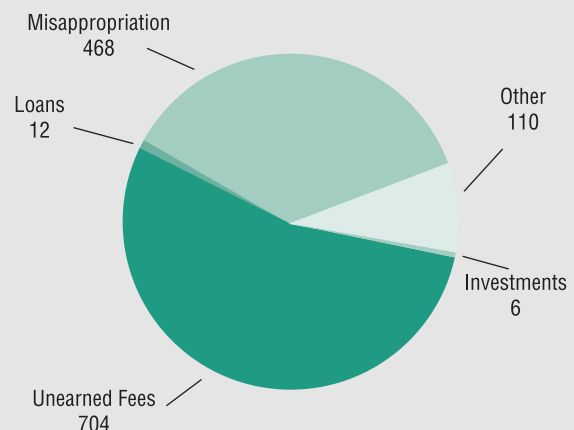
Financed in 2002 by a \$35 annual assessment added to the membership dues paid by California lawyers, the Client Security Fund reimburses victims up to \$50,000 for losses due to attorney theft or an act equivalent to theft. While the number of dishonest lawyers is extremely low, the losses suffered by clients can be devastating. The fund is a cost-effective way of providing reimbursement to victims that is generally not available from any other source. Furthermore, the fund provides the legal profession with a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession.

In 2002, the number of new applications received by the Client Security Fund was the highest it has been in 10 years. As the chart below reflects, the filing rate for new applications dropped significantly in 1998-1999 due to the virtual shutdown of the discipline system during the fee bill crisis (i.e., June 1998 through March 1999). However, in 2001 and 2002 the number of new applications filed has increased to a high of 1,300 in 2002.



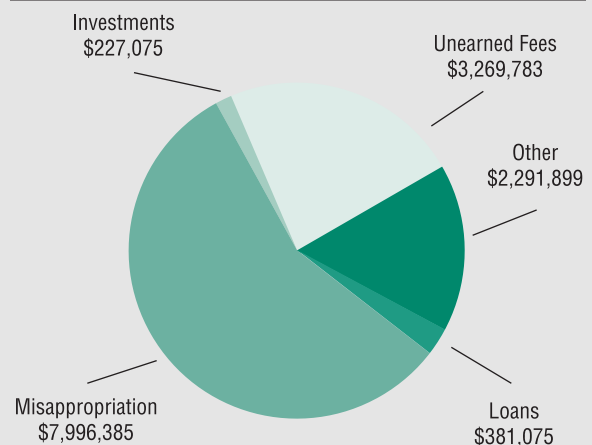
### Number of Applications Filed by Category in 2002 Total: 1,300

The largest number of applications filed was in the "unearned fees" category (54.2%). The second largest number of applications filed was in the "misappropriation" category (36%).



### Dollar Amount of Applications Filed by Category in 2002 Total: \$14,166,217

While "unearned fee" cases comprised the largest number of applications filed, "misappropriation" cases comprised the largest dollar losses reported. Unearned fee cases represented 23.1 percent of all dollar losses reported. Misappropriation cases represented 56.4 percent of all losses reported.



*"My sincerest thanks go to you and your colleagues in regards to the reimbursement funds you gave me. Thank goodness there is an organization such as yours that provides just settlement. Having few financial resources left, it would have been difficult if not impossible to get the money back myself. Thank you again for all your hard work on my behalf."*

(Quote from Applicant September 2002)

## Legislation

Oversight of the Client Security Fund is provided by the Legislature through a series of statutes, and by the Bar's Board of Governors through the Rules of Procedure, Client Security Fund Matters.

The State Bar's authority to operate the Client Security Fund is found in Business & Professions Code section 6140.5. This Legislation, effective March 4, 1972, was a result of a Board resolution dated June 17, 1971 and a Bar-sponsored bill. Section 6140.5(a) requires the Board to maintain a Client Security Fund.

Section 6140.5(b) provides a special statute of limitations whereby the Bar may bring an action to enforce its subrogation rights within three years of the date of payment to an applicant. Another part of the Bar's effort to collect against the errant lawyer is section 6140.5(c) which allows the Bar to add any CSF payout, plus interest and processing costs, to the membership dues bill of any lawyer who has been disciplined or resigns with discipline matters pending and seeks to be reinstated.

Section 6140.55 allows the Board to assess up to \$40 per active member to support the Fund. This assessment is to be used only for the purposes of the Fund. In 2002-2003, \$35 was assessed.

Section 6149.5 serves as an early loss prevention measure. It requires insurers to provide written notice to a claimant of settlement payments of \$100 or more delivered to the claimant's lawyer or other representative in settlement of any third-party liability claim.

Another statute which affects the Fund is section 473 of the Code of Civil Procedure. Under this section, when a court sets aside a default judgment due to a party or attorney's mistake, inadvertence, surprise or excusable neglect, it may (1) impose a penalty of no more than \$1,000, (2) direct the offending attorney to pay up to \$1,000 to the Client Security Fund, or (3) grant such other relief as appropriate. Under this statute, the Fund received \$16,805 in 2002.

## Rules and Coverage

The Fund is governed by the Rules of Procedure, Client Security Fund Matters which were adopted by the Board of Governors on December 21, 1985. Under these Rules, a seven-member Commission, appointed by the Board, acts as the Board's delegate in administering the Fund. From time to time, the Commission recommends to the Board amendments to the Rules of Procedure. Proposed rule changes are circulated for public comment before final action is taken by the Board.

The rules set forth the scope and purpose of the Fund, the authority of the Commission, the requirements for reimbursement, the application process, the confidentiality of the Fund records, and judicial review of Commission decisions. An applicant or Respondent lawyer may seek judicial review of a Final Decision of the Commission in the superior courts of the State under section 1094.5 of the Code of Civil Procedure.

## General Basis for Reimbursement

An applicant must establish the loss of money or property which came into the hands of an active member of the State Bar while acting as a lawyer, trustee or fiduciary as defined in the Rules of Procedure, Client Security Fund Matters, and which loss was caused by a dishonest act as defined under the rules.

## Statute of Limitations

Applications for reimbursement from the Fund must be filed within four years after the applicant discovers or reasonably should have discovered the loss.

## Status of the Lawyer

In order for reimbursement to be paid, the lawyer whose dishonest conduct caused the loss must have been acting as a lawyer, or in a specified fiduciary capacity, such as the trustee of an express trust or as an escrow holder.

Also, the lawyer must have been disciplined, voluntarily resigned, died, been found mentally incompetent or been judged guilty of a crime that involved the loss. The Rules do give the Commission the discretion to waive this requirement under certain limited circumstances - for example, in clear cases when formal charges have been filed but the lawyer has not yet been disciplined.

## Dishonest Conduct

A lawyer's dishonest conduct that can lead to payment from the Fund includes:

- theft or embezzlement of money or the wrongful taking or conversion of money or property;
- refusal to refund unearned fees received in advance where the lawyer performed no services or an insignificant part of the services contracted for such that the lawyer can be regarded as having lacked the intention to perform at the time payment was received;
- the borrowing of money from a client without the intention or the reasonably anticipated ability to repay it;
- obtaining money or property from a client by representing that it would be used for investment purposes when no investment is made; or
- an act of intentional dishonesty or deceit which directly leads to the loss of the money or property.

## Losses not Covered

The Fund will not repay a loss if:

- it was covered by insurance, a bond or another fund;
- it was caused by negligence or malpractice; or
- it was a bad business loss such as a failed investment.

The Fund also does not cover "interest," "incidental or consequential losses" or "expenses" caused by the attorney. Examples of incidental or consequential losses would include fees applicant paid another attorney or damages caused by malpractice, negligence or incompetence.

## Maximum Payment

The maximum allowable payment to an individual applicant is \$50,000 for covered losses. However, there is no limitation on the aggregate amount paid against a Respondent attorney.

*"Thank you so much for all your help in securing this refund. It has meant a great deal to us in being able to recover what we felt was ours! I commend the State Bar in providing such a valuable service to the community."*

(Quote from Applicant April 2002)

## Applications Paid by Category

In 2002, the Fund paid out \$6,597,057 on 782 awards.

Applications in the "unearned fees" category (384) and the "misappropriation" category (389) were paid in almost equal numbers with loans and investments representing only a few of the applications paid.

### Number of Applications Paid by Category in 2002 Total: 782

Unearned Fees	384
Misappropriation	389
Investments	0
Loans	9



### 5-Year Summary of Applications Paid

2002	782
2001	609
2000	595
1999	387
1998	517



## Dollars Paid by Category

In 2002, "misappropriation" cases represented the largest dollar amount of applications paid. \$5,264,559, or 79.8 percent, of all dollars paid out were in the "misappropriation" category. "Unearned fee" cases represented 17.2 percent of all dollars paid out with "investments" and "loans" representing only 3 percent of the total payouts.

### Dollars Paid by Category in 2002 Total: \$6,597,057

Unearned Fees	\$1,132,759
Misappropriation	\$5,264,559
Investments	\$0
Loans	\$199,739



### 5-Year Summary of Applications Paid in Dollars

2002	\$6,597,057
2001	\$4,435,212
2000	\$3,674,000
1999	\$2,811,000
1998	\$3,627,000



## Applications Closed in 2002

Applications "closed" include those that are paid, rejected and withdrawn.

### 5-Year Summary of Applications Closed

2002	1286
2001	1069
2000	1095
1999	767
1998	978

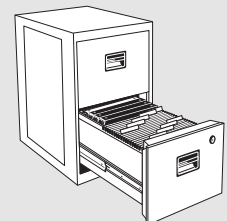


## Applications Pending

The year 2002 closed with 770 applications pending, representing \$10,157,007 in reported losses.

### 5-Year Summary of Applications Pending at Year's End

2002	770
2001	751
2000	708
1999	758
1998	913



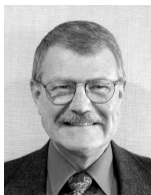
*"Thank you for promptly processing our client's claim. We appreciate knowing that the Security Fund works."*

(Quote from Applicant October 2002)

*"Many thanks to you and your staff for taking care of the problem I had. You handled it in the most professional way. Once again, many thanks."*

(Quote from Applicant November 2002)

## Commission Members



**Alfred R. Conklin, III**, an attorney member, is a writer/analyst with CCH Incorporated. He was appointed in October 2000, and serves as Chair for the 2002-2003 term. His term expires in September 2003.



**Carol A. Klauschie**, an attorney member, is a sole practitioner in Pasadena. She was appointed in September 2000 and serves as Vice Chair for 2002-2003. Her term expires in September 2003.



**Phyllis M. Crittenden**, a public member, is an employee with the Los Angeles Unified School District. She was appointed in October 2002. Her term expires in October 2005.



**Joanne M. Guzman-Hays**, currently a voluntarily inactive attorney member, is a volunteer judge pro tem and former attorney for Legal Aid. She was appointed in September 2001. Her term expires in October 2004.



**Constance A. McClendon**, a public member, is a retired Senior Enforcement Investigator of the Equal Employment Opportunity Commission. She was appointed in October 2002. Her term expires in October 2005.



**Margarita Vazquez-Gomez**, a public member, is an Administrative Manager of the Los Angeles County Internal Services Department. She was appointed in October 2002. Her term expires in October 2005.



**Lauren J. Weil**, an attorney member, worked as a criminal defense attorney for 15 years. She is not currently actively practicing but is involved in a number of volunteer activities. She was appointed in October 2002. Her term expires in September 2003.

*"Just want to drop you a note of thanks for the recent reimbursement to me from the Client Security Fund. It's great to see that such programs are put in place to help consumers such as myself to recover unjustified losses. I also thank the panel for their decision."*

(Quote from  
Applicant March 2002)

*"It is not simply the financial restoration, but a restoration in faith in the structure of society, particularly to an elderly couple who have seen society change so much in their lifetimes."*

(Quote from  
Applicant October 2002)

## Decision Making

Policy oversight of the Client Security Fund is a joint responsibility of the Board of Governors and the Client Security Fund Commission.

The Board monitors the Fund through its: appointment of seven commissioners; approval of recommended changes and additions to the Rules of Procedure; consideration and approval of the Fund's annual administrative budget; and power to seek legislative authority to increase the lawyer's fees that support the Fund.

The Board exercises its authority as an entity and through its Board Committee on Volunteer Involvement.

Of the seven volunteer members who comprise the Commission, no more than four of them may be lawyers. They are assisted by a professional staff of 9 who screen, analyze, investigate and present cases to the Commission.

Among the Commission's key functions are:

- determining applications made to the Fund after a written and oral presentation of the matter by CSF staff and, occasionally, after hearing held before the Commission;
- recommending to the Board of Governors necessary staffing levels to carry out the Fund's business in a professional, timely fashion;
- taking steps to increase the efficiency and timeliness with which the Commission and staff process applications;
- monitoring the Fund balance and recommending to the Board of Governors necessary fee increases to guarantee its continued solvency;
- interpreting the Rules of Procedure through policy statements and recommending necessary amendments and additions;
- and providing for the efficient inner workings of the Commission itself.



### THE STATE BAR OF CALIFORNIA

Client Security Fund  
1149 South Hill Street  
Los Angeles, CA 90015-2299  
(213) 765-1140  
[www.calbar.ca.gov](http://www.calbar.ca.gov)  
Discipline Complaint Hotline: (800) 843-9053



# CLAIMS ACTIVITY 1994 - 2002

## Nine-year Comparison

	1994		1995		1996		1997		1998		1999		2000		2001		2002	
	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount
Claims outstanding, beg. of year	1,031	\$14,585,181	1,221	\$16,729,319	1,197	\$17,354,678	1,236	\$16,306,378	1,223	\$15,849,180	913	\$12,270,996	758	\$10,345,650	708	\$8,803,264	751	\$9,517,404
Prior year's outstdg. claim adj. inc.	-5	40,667	1	140,784	0	159,580	0	116,345	16	339,685	1	101,840	(4)	(10,043)	(2)	110,553	5	\$29,491
New claims	1,065	12,757,016	975	10,117,095	1,082	12,364,140	1,217	12,717,110	652	7,879,099	611	6,780,932	1,049	10,929,128	1,114	11,900,739	1,300	14,166,217
TOTAL CLAIMS	2,091	\$27,382,864	2,195	\$26,987,198	2,279	\$29,878,398	2,453	\$29,139,833	1,891	\$24,067,964	1,525	\$19,153,768	1,803	\$21,264,735	1,820	\$20,814,556	2,056	\$23,713,112
Less: Processed Claims:																		
Paid	418	2,514,586	543	3,229,146	578	5,539,449	708	4,660,614	517	3,627,082	387	2,811,090	595	3,673,850	609	4,435,212	782	6,597,057
Rejected	72	1,974,202	50	2,119,645	90	3,206,604	73	2,982,725	74	2,414,893	69	1,883,065	132	4,061,716	68	2,903,338	39	2,580,784
Withdrawn	380	6,164,760	405	4,283,729	375	4,825,966	449	5,647,314	387	5,754,992	311	4,113,963	368	4,725,923	392	3,958,602	465	4,378,264
TOTAL PROCESSED CLAIMS	870	\$10,653,548	998	\$9,632,520	1,043	\$13,572,019	1,230	\$13,290,653	978	\$11,796,967	767	\$8,808,118	1,095	\$12,461,489	1,069	\$11,297,152	1,286	\$13,556,105
Claims outstanding, end of year	1,221	16,729,316	1,197	17,354,678	1,236	16,306,379	1,223	15,849,180	913	12,270,996	758	10,345,650	708	8,803,264	751	9,517,404	770	10,157,007
Claims outstanding inc./(dec.) over beginning balance	195	2,103,471	(23)	484,575	39	(1,207,880)	(13)	(573,543)	(326)	(3,917,869)	(156)	(2,027,186)	(50)	(1,542,386)	43	714,140	19	639,603
Claims payout ratio	22.91%		27.89%		37.79%		37.90%		32.97%		31.76%		30.20%		33.75%		44.20%	
Est. claims liability at payout ratio	\$3,832,687		\$4,840,220		\$6,162,181		\$6,006,839		\$4,045,747		\$3,285,778		\$2,658,586		\$3,212,124		\$4,489,397	
FUND BALANCE (end of year)	\$1,510,861		\$2,256,475		\$14,972		\$262,515		\$3,417,414		\$6,607,930		\$8,981,524		\$9,022,435		\$5,650,779	
FUND BALANCE (end of year, cash-basis)	\$5,343,548		\$7,096,695		\$6,177,153		\$6,269,354		\$7,444,022		\$9,902,786		\$11,640,110		\$12,234,559		\$10,140,176	

# Financial Picture

To have a complete picture of the fund's fiscal health, it is important not only to see what money is on hand and how much has been actually paid out, but to also know how much is expected to be paid on pending cases. This anticipated payout, or accrued liability, is calculated by multiplying the total dollar amount of the pending cases times an estimated claims payable ratio. The claims payable ratio is based upon how much the fund has historically paid for every dollar claimed. For example, if the fund has historically paid \$.30 for every \$1 claimed, then the claims payable ratio is 30 percent.

The claims payable ratio used by the fund is based upon a 24-month rolling average. The accrued liability changes, not only with changes in the claims payable ratio, but also as the total dollar amount of outstanding applications changes.

The significant drop in the filing rate for applications in 1998 and 1999 due to the virtual shutdown of the discipline system during the fee bill crisis (i.e. June 1998 through March 1999) created a dramatic increase in the fund balances as of year-end 1999 and 2000. Since the fund received significantly fewer applications in 1998 and 1999, the fund's liabilities were significantly reduced thus creating higher balances. In addition, higher balances generated more investment income earned from interest.

## Balance Sheet

The balance sheet shows the fund's assets and liabilities as of December 31, 2002.

Fund assets are maintained in cash and cash equivalents.

Current liabilities include estimated awards ultimately to be paid on applications which are pending as of December 31 plus next year's dues payments received early - for example, 2002 dues received in 2001.

The fund balance or deficit is simply the difference between fund assets and accrued liabilities.

## Statement Of Revenues, Expenses And Changes In Fund Balance

Total revenues consist of members' dues, interest income and other revenues such as contributions.

Expenses include awards paid, accrued liabilities and administrative expenses. Awards constitute the major element. Off-set against this expense are any monies recovered from the bar's collection activities. This is reflected as "Awards Reimbursements (or Recoveries)."

The Estimated Decrease/(Increase) in Awards Payable Liability is an adjustment made at the end of the year because of a change in the accrued liability.

### 2000 - 2002 BALANCE SHEET STATEMENTS

	12/31/00	12/31/01	12/31/02
<b>ASSETS:</b>			
Cash	12,597,946	13,125,799	11,606,160
<b>LIABILITIES &amp; FUND BALANCES:</b>			
Current liabilities	3,616,422	4,103,364	5,949,876
Fund balances	8,981,524	9,022,435	5,656,284
Total liabilities & Fund balances	12,597,946	13,125,799	11,606,160

### 2000 - 2002 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

	12/31/00	12/31/01	12/31/02
<b>REVENUES:</b>			
Membership dues	5,282,440	5,300,730	4,852,118
Investment Income	808,065	609,523	246,996
Other Revenues	-	-	-
<b>TOTAL REVENUES</b>	6,090,505	5,910,253	5,099,114
<b>EXPENSES:</b>			
Awards Paid/Accrued	2,972,490	4,957,724	7,830,169
Less: Awards Reimbursements or Recovery	(232,649)	(222,864)	(715,136)
Total	2,739,841	4,734,860	7,115,033
Administration	977,070	1,134,481	1,350,232
<b>TOTAL EXPENSES</b>	3,716,911	5,869,341	8,465,265
<b>EXCESS (DEFICIT) OF REVENUES OVER EXPENSES</b>	2,373,594	40,912	(3,366,151)
Computer technology fund applic.	-	-	-
Estimated Decrease (Increase) in Awards Payable Liability	640,040	(553,538)	(1,277,273)
Fund Balances, as of year-end	8,981,524	9,022,436	5,656,284